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CENTRAL INTELLIGENCE AGENCY
Office of Current Intelligence
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CURRENT INTELLIGENCE MEMORANDUM

SUBJECT: Ceylon May Lose US Aid

1. The United States will withdraw loan and grant aid to Ceylon, totalling some \$4 million annually, on 1 February if the Ceylonese government has failed by that date to make acceptable arrangements to compensate two American oil companies for portions of their property expropriated last April. Although the sums of money involved are relatively small, the American move is likely to involve Mrs. Bandaranaike's government in domestic difficulties, weaken further the Ceylonese economy, lose significant goodwill for the US and open the way for new Bloc gains in dealing with the country.

2. The dispute has been simmering for about six months. Since the oil company properties, which consist of the most profitable part of their distribution facilities--gas stations, storage tanks etc.--were nationalized, the government-controlled Ceylon Petroleum Corporation reportedly has set aside \$5 million in rupee funds in anticipation of a settlement. The oil company claims may in fact total no more than \$3.6 million. But the Ceylonese laws applicable to the case require that compensation be based on the book value of the expropriated property while the companies--looking primarily to the danger of setting an unfavorable precedent for their dealing with other countries where their interests are larger--have hoped to settle on the basis of "fair market value." Neither side has been in any hurry to bring matters to a conclusion. The Ceylonese government waited until last December to take legal actions required to enable the companies to file compensation claims, and as of mid-January the companies, obviously waiting to see whether diplomatic pressure and the threat of US aid withdrawal would work, had

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State Dept. review completed

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not yet filed their claims. The only significant forward movement has been that the Ceylonese government, under pressure from the US embassy, has agreed to negotiate with the companies for a lump sum payment following the filing of claims.

3. The impact of the withdrawal of even the small amount of US financial assistance which Ceylon currently receives would be significant. Although the Ceylonese standard of living compares favorably with those of nearby Asian countries, during the past ten years successive governments have been unable to expand food production or provide jobs for the rapidly growing population. Half of Ceylon's growing food needs are met by imports, and there has been a continuing drain on foreign exchange reserves, which are down to about \$100 million. This is a dangerously low level in the light of the country's import requirements, which amount to about \$370 million annually. Measures taken last year to cut imports drastically have resulted in losses of government customs revenue, dislocation of the commercial community, and increased unemployment.

4. The oil issue is likely to complicate further Mrs. Bandaranaike's efforts to cope with economic problems. On the one hand, her leftist opposition is strongly urging her to stand firm against American imperialistic pressures. Her conservative critics, on the other hand, denounce the government's bungling and would become even more vociferous if Mrs. Bandaranaike appeared to have thrown away a source of foreign exchange through doctrinaire stubbornness. Even if US aid were soon resumed, these political wounds would remain to damage US-Ceylon relations.

5. To meet the situation and her critics if US aid is actually withdrawn, Mrs. Bandaranaike and her advisors might try to get the Bloc to make up Ceylon's financial deficiencies. For this fiscal year, the Colombo government is relying on foreign aid from all sources to cover about \$32 million of an expected budget deficit of \$83 million. In addition to the \$4 million US aid (\$3 million in loans and \$1 million in grants) annually, US PL-480 commodity aid comes to some \$10 million a year. The sums involved would pose the Bloc little difficulty. Furthermore, the Bloc already is gaining in terms of its trade with Ceylon. During the first nine months of 1962 both import and export trade with the Bloc rose over thirty per cent above the corresponding period in 1961, while imports from the US declined by over 31 per cent and exports to the US increased by less than one per cent.